(13) (12)

Nos. 94-1893, 94-1900

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
Petitioners,

v.

CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,
Respondents.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioners,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the
United States Court of Appeals
for the Fourth Circuit

BRIEF OF *AMICUS CURIAE* EAST ASCENSION TELEPHONE COMPANY IN SUPPORT OF RESPONDENTS

SYLVIA LESSE
KRASKIN & LESSE
Suite 520
2120 L Street, N.W.
Washington, D.C. 20037
(202) 296-8890

RICHARD A. EPSTEIN
Counsel of Record
1111 East 60th Street
Chicago, IL 60637
(312) 702-9563

Counsel for *Amicus Curiae*

October 18, 1995

15pp

TABLE OF CONTENTS

TABLE OF AUTHORITIES

INTEREST OF *AMICUS CURIAE*

East Ascension Telephone Company, Inc. provides local telephone service in parts of Louisiana. As a small telephone company, it cannot afford uneconomic investment to build a utopian common carrier video network as the sole means of providing video programming in its telephone service area. The disposition of this case urged by Petitioners, therefore, would have the practical effect of silencing East Ascension as a video speaker and of depriving East Ascension's subscribers of an alternative to the cable incumbent. Letters indicating the consent of the parties to the filing of this brief have been filed with the Clerk.

BACKGROUND OF THE CASE

At issue in this case is whether § 533(b) of the Federal Communications Act abridges telephone company speech in violation of the command of the First Amendment. The central argument has already been developed in the principal brief submitted by Bell Atlantic. Only a brief recapitulation of the basic facts is necessary here.

Through its subsidiary Bell Atlantic Video Services (BVS), Bell Atlantic seeks to provide video programming in direct competition with cable TV operators in Bell Atlantic's telephone service area. Section 533(b) bans all telephone companies, which are regulated as common carriers under the Federal Communications Act, from providing video programming to their telephone subscribers. Bell Atlantic, like East Ascension and other telephone companies, is caught by that restriction. Under § 533(b), any telephone company regulated by the FCC may passively transmit the programming of other providers over its own network; it may seek a broadcast license to transmit some of its own programming over a broadcast frequency in its own home region or elsewhere; it may sell its programming to cable TV stations anywhere so long as it can find a buyer; and it may provide video programming directly to customers outside its home region. But it cannot follow its obvious low-cost business strategy: Enter into the business of video programming in its own home region. The statutory prohibition holds whether a telephone company seeks to transmit its message over its own extant telephone facilities, or whether it seeks to build, purchase, or lease separate facilities for that purpose. And the statutory prohibition within the home territory holds whether the phone company

seeks to operate its video facilities as an ordinary private owner or as a common carrier.

This statutory ban on telephone company video programming amounts, as the Fourth Circuit held, to a flat prohibition of telephone company speech. Pet. App. 49a-51a. Given that unexceptional finding, the burden switches to the Government to justify that statutory prohibition by identifying some legitimate end of the ban, under (at the very least) a standard of intermediate scrutiny. And it must show that the legitimate end could not be achieved in a more expeditious and efficient way. *See Turner Broadcasting Sys. v. FCC*, 114 S. Ct. 2445, 2469-70 (1994). The Petitioners seek to meet that burden by showing that this legislative ban was, and is, necessary to prevent cross-subsidization of Bell Atlantic's video distribution services by its other common carriage telephone services. Their argument is that telephone companies hold powerful local monopoly positions that could allow them, if unchecked, to shift the costs of their video programming venture to their regulated businesses. The resulting subsidies could create distortions in two markets: the subsidized video programming market, and the subsidizing telephone market. *See generally* Averch & Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 Am. Econ. Review 1053-1069 (1962); Staff Report, FCC Policy on Cable Ownership (Nov. 1981), JA 54-58.

The Fourth Circuit assumed the theoretical legitimacy of the cross-subsidy concern, but held that the total ban of § 533(b) was nonetheless not tailored to fit the concern. In passing, the Fourth Circuit mentioned at least one less restrictive form of regulation available to the FCC: The FCC could allow the telephone companies to enter the video programming market in their own region, subject to common carrier obligations similar in form to those imposed on their core telephone business. That proposal was specifically tailored to fit the business plan of Bell Atlantic whose complaint alleged that BVS "will provide some of the video programming on the network, and the network will also be available for use by other video programmers on a common carrier basis." Complaint ¶ 28, JA 13.

Now, in its brief to this Court, the Government asserts that *all* telephone companies should be required to seek waivers of § 533(b) and that waivers will be dispensed only if the applicant submits to a common carriage requirement. Govt. Br. 40. This requirement would be contrary to the business plans of East Ascension Telephone Company, which wishes to enter the video programming market as an

ordinary private business and to compete on the same regulatory terms as the incumbent cable TV operators.

The Fourth Circuit explained its common carrier proposal as follows:

> Moreover, we agree with the district court, 830 F. Supp. at 930-31, that an "obvious less-burdensome alternative[ ]" to Section 533(b) readily presents itself (and indeed has been identified by the FCC as a possible alternative to Section 533(b) in its recommendation to Congress to repeal the provision): Congress could simply limit the telephone companies' editorial control over video programming to a fixed percentage of the channels available; the telephone companies would be required to lease the balance of the channels on a common carrier basis to various video programmers, without regard to content. *See Video Dialtone Order*, *supra*, 7 F.C.C. Rcd. 5781 ¶¶ 141-143.

Pet. App. 47a-48a.

The FCC Order to which the Fourth Circuit refers offered only a brief analysis of the common carrier option to § 533(b). *Video Dialtone Order*, 7 FCC Rcd 5781, ¶¶ 141-143 (1992). The Commission suggested that the appropriate fraction of channels a telephone company could reserve for itself is on the order of 25 percent. *Id.* at ¶ 143 n.360. An earlier Staff Report had suggested that the appropriate fraction should be between 20 to 30 percent. JA at 68. According to the Staff Report, if the telephone company is allowed to have a larger share, say 80 percent, then it could retain some monopoly power that would allow it to cross-subsidize its video programming services. Alternatively, if its retained percentage were too low, say 5 percent, then the telephone company would have little incentive to build its new video transmission facilities in the first place. The 20-30 percent figure was the Staff Report's educated guess designed to split the difference between these two extremes.

The FCC has carefully expressed the telephone company's common carrier obligation as a *percentage* of the total system. If the telephone company could set some minimum guaranteed number of channels, then, according to the Staff Report, it would have a powerful

incentive to build a video transmission system just large enough to cover its own needs, just as any private operator would do. JA 68.

Simply stated, common carrier status is said to control the theoretical risk of cross-subsidy of video programming while permitting more telephone company speech than is possible under the § 533(b) ban. The implicit logic of this argument is this. The telephone company is required to build a system four times the size it needs for its own use. Any effort to subsidize that system would necessarily result in the telephone company granting three-quarters of the subsidy to independent programmers. The inability to keep most of the subsidy for itself would reduce whatever incentive the telephone company would have to create it in the first place. Since this common carrier alternative is less restrictive than the ban and, in the FCC's view, as effective in countering any alleged cross-subsidy risk, the Fourth Circuit concluded that the alternative helped to show that the ban is not sufficiently tailored to the cross subsidy concern, whatever its validity.

The constitutionality of this common carrier requirement was not litigated below. The Fourth Circuit did not examine this suggestion, which it made for only a limited purpose. "We cite the alternative not to imply its constitutionality, but only to show that Section 533(b) is itself unconstitutional." Pet. App. 48a n.34.

In *FCC v. Midwest Video Corp.*, 440 U.S. 689 (1979), this Court struck down a comparable but less onerous requirement that applied to cable operators. The FCC had ordered all cable systems over a certain size to expand their capacity from a then-average 12 channels to 20 channels, and to offer some of the new channels for public use on a common carrier basis. The Court invalidated the FCC's rules as contrary to a statutory requirement that cable service not be subject to common carrier regulation. *See* 47 U.S.C. § 541(c)("Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service."). The Court also noted that subjecting cable channels to common carriage came "at the expense of the journalistic freedom" of cable operators to compose their own package of programming. 440 U.S. at 707. "[E]ven when not occasioning the displacement of alternative programming, compelling cable operators indiscriminately to accept access programming will interfere with their determinations regarding the total service offering to be extended to subscribers." *Id.* at 707 n.17. The Court did not reach the First Amendment and Takings Clause issues presented by the FCC's rules, but noted that these were "not frivolous." *Id.* at 709 n.19.

More recently, the common carrier possibility for both cable and telephone companies was discussed in Justice O'Connor's concurring opinion in *Turner Broadcasting*, 114 S. Ct. at 2475, as an alternative to compelling cable operators to carry local broadcast channels:

> If Congress finds that cable operators are leaving some channels empty — perhaps for ease of future expansion — it can compel the operators to make the free channels available to programmers who otherwise would not get carriage. *See PruneYard Shopping Center v. Robins*, 447 U.S. 74, 88 (1980) (upholding a compelled access scheme because it did not burden others' speech). Congress might also conceivably obligate cable operators to act as common carriers for some of their channels, with those channels being open to all through some sort of lottery system or timesharing arrangement. Setting aside any possible Takings Clause issues, it stands to reason that if Congress may demand that telephone companies operate as common carriers, it can ask the same of cable companies; such an approach would not suffer from the defect of preferring one speaker to another.

Turner Broadcasting, 114 S. Ct. at 2480.

ARGUMENT

The main purpose of this brief is to show that the hesitation that the Fourth Circuit expressed about the unconstitutionality of the common carrier alternative and that Justice O'Connor expressed about possible Takings Clause issues is in fact well founded. Analyzed in some detail, it becomes clear that *in this context* common carrier regulation, whose details are still unknown but are irrelevant to the argument made in this brief, would place far too great a burden on First Amendment freedoms to withstand examination under the intermediate scrutiny standard of *Turner*. The conclusion is plain: Just as the First Amendment makes it impermissible for the FCC (under strict or intermediate scrutiny) to ban the telephone companies from providing video programming in their region, so too it prevents the FCC from conditioning the right of

telephone companies from entering that market on their willingness to accept some as yet unspecified form of common carrier status.

I. There Is No Compelling Reason for Common Carrier Regulation of the Video Programming Business

Historically, common carriage obligations have never been thrust upon private businesses without their consent. Instead, these obligations attach only after a firm decides voluntarily to enter a business that is subject to common carrier regulation. In this regard, it is instructive to note that the Communications Act of 1934 defines a common carrier as "any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio." 47 U.S.C. § 153(h). The regulations amplify that definition by stating that a communication common carrier is "[a]ny person engaged in rendering communication service for hire to the public." 47 C.F.R. § 21.2 (1994). The effect of these two definitions is to link the communications definition of a common carrier to its common law origins, and that in turn stresses the quasi-public nature of the undertaking: "the primary *sine qua non* of common carrier status is a quasi-public character, which arises out of the undertaking to carry for all people indifferently." *National Ass'n of Regulatory Util. Comm'rs v. FCC,* 533 F.2d 601, 608 (D.C. Cir. 1976) (internal quotation omitted). The key element of this definition is the "undertaking" by a given firm to serve all individuals. It is therefore possible for a single company to engage simultaneously in two types of business, one for common carriage, and the other directed toward particular customers only. *See Midwest Video Corp.*, 440 U.S. at 701 n.9 ("one can be a common carrier with regard to some activities but not others"). Thus in *Southwestern Bell Telephone Co. v. FCC,* 19 F.3d 1475 (D.C. Cir. 1994), the Court of Appeals held that the FCC could *not* regulate as common carriage a certain "dark fiber" service just because some telephone companies had provided it "as a limited, customer-specific service." 19 F.3d at 1481. Accordingly, the carriers were allowed to discontinue offering dark fiber service, without first receiving FCC approval.

The decision in *Southwestern Bell* fits in well with the basic logic of common carrier regulation. Food, clothing, and shelter are necessities of life, but they are not provided under a common carrier

regime that requires firms in these lines of endeavor to take all customers indifferently. The vast range of private alternatives provides consumers with all the protection that they need. The discontinuation of dark fiber service at issue in *Southwestern Bell* did not disrupt or impair the efficiency of the overall telephone network. As such that service was correctly treated as a private service, analogous to the wide variety of services found in ordinary markets. By way of parallel, the video programming services at issue in this case need not be regulated as common carriage to assure the operation of the telephone network, any more than dark fiber service needs to be so regulated. Video programming can be offered on a limited basis to select groups of customers, as in *Southwestern Bell,* and their possible discontinuation does not threaten the viability of the overall telephone network.

So understood, the present case illustrates the powerful economic logic behind the distinction between common carrier and private services. The core telephone transmission services of 1,000 separate telephone companies of all sizes and capacities have to be knitted together into a single cohesive network in order to facilitate the transmission of information from any point in the network to any other point in the network. In this environment, common carrier regulation ensures that telephone companies do not refuse service, or set price so high as to deter service, either to telephone users or connecting carriers. This regulation always carries with it the risk of confiscation, but that risk can be checked effectively by insisting that all carriers receive a just rate of return on the investments committed to their common carrier businesses. At the same time, such regulation need pose no threat to fundamental First Amendment values because it does not limit the speech of the telephone companies.

The same sunny view of common carrier regulation is not appropriate in the novel context of video programming services. Requiring the carrier to serve all customers at a regulated price has never been easy even for public utilities that face relatively stable demand for their outputs that are in turn produced by relatively stable technology. In the fast-moving video programming market, instability and innovation are the only permanent truths, and these conditions make it difficult to fashion reliable rates to reflect the rapid shifts on both the cost and the demand side of the market. Worse still, there is no guarantee that any channels built at telephone company expense and dedicated by law to common carrier status will be leased by other programmers, so that the telephone company could be left with the

worst of both worlds: sharp restrictions on its rate of return if the venture proves successful and demand is high, and no compensation from the Government if its common carrier lines lay vacant.

II. The Just Compensation Remedy for Idle Channels Is Not Clearly Available Under Current Takings Jurisprudence

One possible way to meet this difficulty is to insist that compensation be provided to the telephone companies if forced to construct expensive facilities that then remain idle. One plausible way to make this argument is to treat the United States as though it leased those vacant channels for its own purposes when it refuses to allow the telephone companies to use these channels themselves. By excluding the telephone companies from the use of their own property, it is as though the Government has taken possession of them. It must then pay compensation for the time it uses the channels in question, just as it must pay compensation when it occupies a building for an indefinite term of years against the will of its owner. *See, e.g., General Motors v. United States,* 323 U.S. 373 (1945).

It is, however, an open question whether this compensation claim would be honored by the Government, or indeed accepted by the Court. The precise question of whether an exclusion from the possession of some portion of the system constitutes a taking is not settled under this Court's takings jurisprudence. It is not crystal clear whether the requirement that certain channels be left vacant will be treated as a physical taking, for which there is a virtual per se rule of compensation, *see Loretto v. Teleprompter Manhattan CATV Corp.,* 458 U.S. 419 (1982), or in the alternative whether it will be regarded as part of a regulatory initiative for which compensation is required only when the regulation denies the owner of the property (presumably the entire facility) any "economically viable" use. *See Lucas v. South Carolina Coastal Council,* 112 S. Ct. 2886 (1992).

Both these tests raise formidable difficulties of their own. *Loretto,* for example, involved the permanent physical occupation of space that is strongly analogous to the "electronic occupation" that occurs when a telephone company's computers and cables are forced either to carry the video programming of others or sit idle. But the *Loretto* definition of physical taking has not been uniformly applied. In *Yee v. City of Escondido,* 503 U.S. 519 (1992), the occupation of a pad by a mobile

home tenant was held to be "a regulation of petitioners' *use* of their property, and thus does not amount to a *per se* taking." *Id.* at 532 (emphasis in original). And that same conclusion was held to follow from the fact that the landowners chose to "voluntarily open" their premises to others.

In our view, the forced idleness of particular property should be treated as a physical taking, compensable for the full period of its duration. It is not credible to assert that a telephone company's decision to build four times the needed video transport capacity is "voluntary" when the FCC has mandated such excess construction as the price of the telephone company's video speech. Even if the forced idleness is regarded only as a regulatory taking, the better view treats the period of idleness separately. Since no revenues have been collected for that period, explicit compensation from the Government should be required to make up the Government-created shortfall. In rate regulation generally it is improper to reduce the recovery allowed in the current period to reflect some larger than anticipated gains made in some previous rate period. "Past losses cannot be used to enhance the value of the property or to support a claim that rates for the future are confiscatory. And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations." *Board of Public Utility Comm'rs v. New York Telephone Co.,* 271 U.S. 23, 31-32 (1926) (citation omitted).

III. The Absence of Clear Protection Against Forced Idleness of Common Carrier Video Programming Channels Will Retard Telephone Company Entrance into the Field

For these purposes, however, it is not necessary to reach a definitive resolution of a difficult takings question. The critical point is to note the cautious legal advice on the compensation question that must be given to a telephone company that wished to operate its own video programming facility. There is no way that such a company could be assured that compensation for its idle channels would be required under present law. The lack of clarity of the just compensation question thus lends additional urgency to the telephone company's First Amendment claim that unsettled policies effectively silence its right to speak. The very uncertainty of the status of the compensation remedy only underscores the legal risks that any telephone company would bear

in committing its resources to such a hazardous business venture. Does it take the risk that the government will refuse to pay compensation for the rental value of vacant channels? That it will offer some inadequate compensation? What are the costs of future litigation if disputes arise, and the possibilities of success?

Nor are these difficulties obviated by trying to take the idle capacity into account in ratemaking procedures. Here, it is conceivable that the FCC or state regulators could allow a telephone company to set rates high enough to recoup the lost revenues in some future period. But once again, there is no guarantee that this form of deferred compensation will provide any effective relief to the telephone companies. It is one thing for the regulator to allow certain rates. It is quite another for the market to pay those rates. Should a demand emerge for the once vacant channels, no potential customer in a competitive market will pay for the downtime of the channel prior to its own use. Those costs are sunk and hence cannot be recovered. Thus, the telephone companies would face this unpleasant dilemma. If the FCC sets the rates too low, the telephone company has no choice but to lease channels at those reduced levels. But if it sets them too high, then potential lessees will simply refuse to deal unless they receive price concessions. The telephone companies can lose from regulation but not gain.

The scope of the government intrusion, it should be evident, is much greater than the intrusion inflicted on the mall owner in *PruneYard Shopping Center v. Robins*, 447 U.S. 74 (1980). In *PruneYard* the mall owner did not attack, and this Court did not address, the protester's intrusion on the ground that it was forced to subsidize speech to which it was opposed. Accordingly, this Court allowed the protesters' activities for reasons that are inapplicable here. The mall owner could not make a credible showing that its patrons would confuse the message of the protesters with the views of the mall owner; and the Court found no evidence in the record to indicate that the presence of protesters in the Mall would cause any economic loss to the mall owner's operations. In contrast, the burdens of common carrier status on a telephone company are far greater. In this context, every channel that is used by lessees is a channel that is not available to the owner of the facility. Every decision to commandeer resources reduces the likelihood that the facility will be produced in the first place. Here the required lessees and the telephone company are in the same video programming business, so that the risk of confusion of

messages and consequent loss of advertising and good will is far greater. That greater negative impact of government regulation means that this common carrier system for video programming fails under a standard of intermediate scrutiny.

The basic point here can be made by yet another analogy if we step back from the fast-paced world of telecommunications. Ordinary office and housing markets contain both leased and owner-occupied facilities. There is little reason to think that sensible firms operating in a competitive market cannot decide whether to pursue ownership or lease. If certain rooms lay vacant and may be needed for future expansion, the sensible owner can decide whether to hold them off the market, to rent them on a short term lease at a below-market price, or to rent them on a long-term lease at a higher price reserving to itself a buyback option. No system of rent control could do better for that owner or his potential tenant (who wants the unit to be available in the first place) than their combined voluntary choices, for no outsider has information about the needs of the two parties superior to that they themselves possess. It would be odd in the extreme therefore for the State to tell any landowner, "we will let you build a home for yourself so long as you occupy only one unit in a four unit complex" (to get the desired 25 percent ratio). It is more than odd to impose that requirement on a video programmer that has explicit First Amendment protection. The obligations that are contemplated by this common carrier suggestion are onerous even if ideally implemented and suffocating if not. The huge level of uncertainty associated with any such program means that this Court should look on the proposal with deep suspicion. It should not preserve § 533(b) by looking to unknown systems of common carrier regulation with distinctive pitfalls of their own.

Justice O'Connor's modest suggestion in *Turner* that "Congress *might . . . conceivably* obligate cable operators to act as common carriers for *some* of their channels" (114 S. Ct. at 2480 (emphasis added)) is not to the contrary. In addition to the just compensation issues that she has identified, another First Amendment issue is also raised. Justice O'Connor thought that her proposal could be subject to a reduced standard of review because it "would not suffer from the defect of preferring one speaker to another." *Id.* But in the context of this litigation, that condition would no longer be satisfied when both telephone companies and cable companies compete in the same market. The FCC's proposal to saddle telephone companies — and only

telephone companies — with a common carriage requirement explicitly prefers one speaker to another. By exempting the cable companies who wield monopoly power in video distribution and imposing the common carriage requirement only on new entrant telephone companies, the FCC is deterring competition and unfairly and selectively burdening the video speech of telephone companies such as East Ascension Telephone that would not voluntarily elect common carrier regulation.

CONCLUSION

The FCC should not be permitted to salvage § 533(b) by appealing to an unknown and untested system of common carrier regulation for video programming. Here is yet another case where the simple solution is best. Section 533(b) should be struck down. If Congress or the FCC wishes to regulate anew in this area, they may do so, but only subject to the constraints of the First and Fifth Amendments.

Accordingly, the decision below should be affirmed.

Respectfully submitted.

SYLVIA LESSE
KRASKIN & LESSE
Suite 520
2120 L Street, N.W.
Washington, D.C. 20037
(202) 296-8890

RICHARD A. EPSTEIN
Counsel of Record
1111 East 60th Street
Chicago, Illinois 60637
(312) 702-9563

Counsel for *Amicus Curiae*

October 18, 1995